How to Make and Keep Stock Market Profits

HOW TO MAKE AND KEEP STOCK MARKET PROFITS

The greatest trust between man and man is the trust of giving counsel.

—BACON.

VAN STRUM FINANCIAL SERVICE

Investment Counselors

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AT the time this book goes to press the stock market has just passed through the most severe panic in history. Within the short space of a few weeks, values on the Stock Exchange have been cut in half. Today, investors and speculators throughout the country are taking stock of their resources and looking anxiously into the future to see what it holds in store for them.

We believe that today, investors need a clear understanding of the economic forces which dictate the market's future. From this volume it is believed that the investor can obtain a clear, workable understanding of those investment principles which must be followed if one is to make continuous stock market profits.

VAN STRUM FINANCIAL SERVICE.

Illustrated by S. H. Wainwright, Jr.

Revolutions Never Go Backwards

"I told you so! It can't be otherwise. Common stocks are speculative, many of them outright gambles."

So speaks the bond investor after a severe crash in stock prices, with the air of a man who has lived to see his principles vindicated, and who has doggedly held to what he regarded as the only sound investment policy through years of rising stock prices.

"Only a temporary set-back," answers the common stock investor. "The country is rich and growing, corporations are in powerful financial condition. The break in stock prices was vastly over-done, the recession in business we are now having is only a lull in a long period of almost uninterrupted growth. American business has wonderful vitality, and even now a new bull market is in the making."

What is the answer? How can investors build an independent income with their savings?

Years ago, before machines transformed our manufacturing processes, our forefathers dealt in terms of tangibles. As craftsmen, shop owners, foremen, and even land owners, they produced articles which could be traded for other products which they needed. Today our industrial and financial system is highly complex; we deal in intangibles. Pieces of paper are the symbols of creditorship and ownership in financial and industrial concerns which in many cases we never see. We must go back to the beginning of the industrial revolution if we wish to understand this complex system.

In 1763, Hargreaves invented the spinning jenny, and a year later Watt followed with the steam engine. These two machines were but the first of an endless series of machines which for over a century and a half have been supplanting hand labor on a large scale and providing means of transporting products to distant markets. Fulton and Fitch amazed an incredulous world with their steam boats. Whitney revolutionized the cotton industry with his cotton gin. Newboldt with the iron plough, Whitmore with the card-

ing machine, and Evans with the high pressure steam engine were a few of the early inventors who started the industrial revolution, a movement which seems to gain momentum with each new year.

Machines led to factories. Workers were forced to leave their small shops where they had worked by hand because they could not compete with machine made products. They swarmed to the factories, creating cities by the sheer force of their numbers. Machines became the order of the day, and men found that they were paid, not in other products as before, but in cash. Thus mass production of goods had a profound effect upon economic society.

As machinery became more complicated, goods were produced by a few large factories. Producing plants grew larger and an increasing amount of capital was necessary to operate them. The companies first turned to the wealthier people in the community, and offered them a share in profits if they would supply the needed capital. The first security given was a common stock certificate, a part ownership in the business. Because of the risk incident to these early enterprises, such transactions were principally of a local

Dollar for Dollar

During the greater part of the nineteenth century, the conservative investor of moderate wealth regarded gilt edge bonds as the most acceptable investment medium. Through bonds he could obtain a fixed income and could be relatively sure that upon maturity his principal would be returned to him in full. To be sure, bonds fluctuated in value, but those fluctuations were far less wide than in the case of common stocks.

During the last quarter of the nineteenth century bonds attained the peak of their popularity as an investment medium, and that period may justly be called the era of the "bloated bond holder." The reason for their popularity is not difficult to find. From 1870 to 1900 interest rates were falling and long term bonds which paid a fixed rate of interest over a period of years, rose steadily from an average of 80 to 110 by 1897. Meanwhile, the cost of living was

declining, and the bond holder was profiting in two ways: Not only was his investment worth more in dollars but the purchasing power of both his capital and income was increasing.

The turn of the century, however, marked a radical change in economic conditions. Since 1900, economic forces have worked to the disadvantage of the bond holder. Discoveries of gold in the Rand and Alaska brought large supplies of the precious metal into the market. The supply of money increased more rapidly than the supply of goods, and consequently commodity prices and the cost of living began to rise, slowly at first, then with increasing rapidity. In 1897 commodity price indices were around 72, while today, even after the tremendous collapse of commodity prices in 1920, they have reached a level of 190. Those who invested in bonds in 1897 have seen their purchasing power dwindle to less than one-half. Those who depend upon bonds to maintain their standard of living, have found that at times it is disastrous to do so.

Bonds are completely at the mercy of commodity prices and interest rates. One

Gilt Edge Bull and Bear Markets

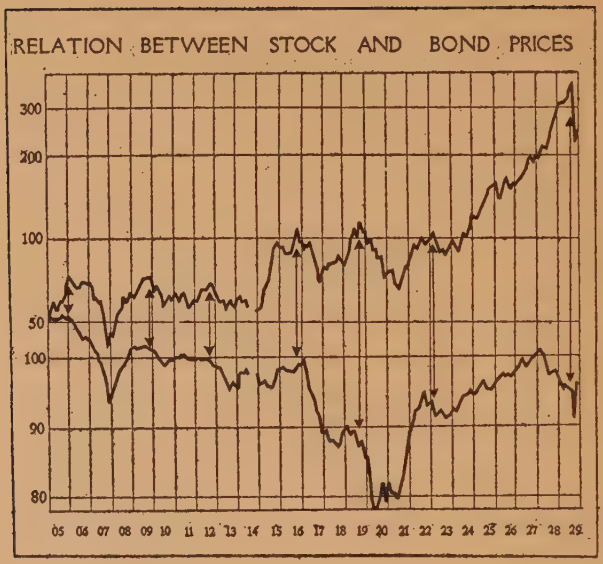
No bond is so good that it does not need watching. Between periods of business prosperity and depression bond prices move over a wide range. Even United States Government 4¼% bonds have sold below 83 and British Consols have moved over a range from 114 in 1896 to 52 in 1917. And these are the two highest grade bonds in existence!

The price of high grade bonds is chiefly dependent upon money conditions which in turn are affected by the same fundamentals which determine stock prices. When credit is in demand, such as during periods of great business activity or during a war, bond prices decline steadily. When money rates decline, because business is less active or because of an increased supply of credit from any source, bond prices rise. To obtain the best results investors must keep in constant touch with fundamental conditions in order to sell their bonds before a

period of declining prices sets in. Many investors believe that bond prices and stock prices move in opposite directions. According to this theory it is possible to keep funds invested in bonds while bond prices are rising, and then to shift to common stocks in order to obtain the benefits of a strong bull move in stock prices. They believe that by thus shifting their funds, they can keep their money in securities which are constantly increasing in value.

Actual figures and charts prove, however, that bond and stock prices generally move together. While bonds generally move downward before stocks in the downward trend of the business cycle, this is largely due to the fact that high money rates, which are typical of the closing phases of a bull market, affect bonds more quickly than stocks. On the upswing the turning points for stocks and bonds coincide more closely.

This close relationship between the trend of stocks and bonds is even more evident in the case of more speculative bonds, and especially those with convertible features or warrants. As



The upper curve represents stock prices and the lower curve, bond prices. It will be noticed that the trends of stock and bond prices correspond closely.

This relationship is particularly evident during a downward trend of stock prices. Because of this situation, it is unwise for investors to shift from stocks to bonds, or vice versa, when they think the price trend of one type of security is changing.

Investors who wish to conserve their capital when the general security market is declining should keep their funds in cash or short term securities, which fluctuate over a very narrow price range compared with stocks or long term bonds.

in the case of stock prices, the more speculative bonds tend to rise when investors are optimistic regarding the future and tend to fall when they are pessimistic.

Because stocks and bonds do move together, the investor who seeks continuous profits on his capital should not switch from stocks to long term bonds but should settle definitely upon the form of investment that best satisfies his need. He should then watch the economic trend closely in order to take advantage of every opportunity that develops.

A Price for a Privilege

During a period of rapidly rising stock prices, investment bankers find it very difficult to sell bonds unless they attach to them the right to convert into stock or attach warrants to buy common stock at a certain fixed price. Investors demand the opportunity to obtain speculative gains on their investment as well as to be assured that their capital is safe. But the fact is that most convertible bonds do not have so strong a credit position as most bonds selling on a comparative yield basis, for they are apt to be merely promises to pay based upon the earning power of the company, and not secured by physical property. Such bonds, merely because of their convertible feature, sell at a higher price than other bonds of equal credit standing.

It is true that the investor may convert his bonds into stock if the company proves successful. In this way he can profit by its success. But the success of any company is based upon certain fundamentals which the trained economist

has no difficulty in recognizing. If the convertible bond holder had the trained economist's foresight, he would be able to buy common stocks outright rather than through the indirect means of convertible bonds, and would benefit by so doing.

For example, an investor buys $1,000 worth of bonds convertible into ten shares of stock. At the time the stock is selling for $50. Another investor buys $1,000 worth of common stock at the same time, at $50. He gets 20 shares of stock. When the stock reaches 100 the bond holder may surrender his bonds and secure $1,000 worth of stock. Meanwhile, the stock of the investor who bought the common at 50 is worth $2,000. His investment is already worth twice as much as that of the bondholder.

Naturally, no one will buy convertible bonds unless he feels the company will succeed. If the company succeeds, common stock is more profitable from the start. Of course, as long as the convertible bonds are held, they will yield a certain income whether or not the common does. Convertible bonds are

usually not very well protected, however, and will suffer if the company's earnings do not rise. This fact leads Professor Dewing of the Harvard Business School to observe that "In its simplest form the convertible device consists of selling stock for more than it is worth at the time that it is sold."

Ready Money Is Aladdin's Lamp

Investors often find it advisable or necessary to keep their capital in liquid form so they can obtain it at short notice. Corporations and governments frequently buy fixed income short term securities which they can sell at any time without loss of principal. Occasionally it is to the advantage of the investor to do likewise. Particularly is this true when the future trend of stock prices seems uncertain.

Some of the most suitable forms of investment for this purpose are call loans, savings bank deposits, bank certificates of deposit, government notes, bank acceptances, commercial paper, and short term notes and bonds of corporations. The fact that these types of investment call for the repayment of principal at an early date prevents any substantial fluctuation in price.

Since the loan is only for a short period of time, the problem of selecting the one of these various forms of invest-

ment best suited to the individual's needs is a personal one. The size of the loan to be made and the period for which it is to run are perhaps the most important considerations. There is almost no risk in these forms of investment, and consequently the opportunities for gain are practically non-existent. Therefore, supervision is necessary, not so much for protection of capital, as to determine when these securities should be sold and the funds invested in common stocks or bonds.

Short term, fixed income bearing securities can well be employed by all investors who wish to maintain some of their funds intact for a relatively short period of time, in order that they may be in a position to take advantage of unusual investment opportunities when they are presented.

Financial Hybrids

As new methods of financing corporate enterprises were originated, the preferred stock took its place as an important type of security. This "compromise" stock, as it has been called, was issued to meet the needs of investors who were willing to take a somewhat greater risk than bondholders, but who wished a more assured and more regular dividend than offered by common stock. Preferred stock usually has priority rights over the common in the matter of dividends and also has prior rights over the common if the company is dissolved.

There are fashions in investments as in other fields. Almost every investor has his personal opinion as to what the ideal security should be. Preferred stock has been issued in many forms to meet the various demands of investors, and as a result, there are innumerable variations in the privileges and restrictions attached to them. Some preferred is entitled to cumulative

dividends whether or not they are earned; some is entitled to share additional dividends after the common gets a certain return. Preferred may or may not have voting power. It may in some cases be convertible into common. In fact, there are so many variations that it is impossible to generalize on its desirability as an investment medium.

Preferred stocks may have practically the same privileges as bonds, as well as their limitations. Great Northern Preferred, on the other hand, is not preferred at all, but is literally common stock.

Since preferred stock was originally designed to give the investor certain advantages which both common stocks and bonds enjoy, it was only natural that this new type of security should combine some of the weaknesses of both. The preferred stockholder is, after all, an owner of the business but there is a limitation upon the profits he can obtain. If earnings are inadequate to cover dividends, the dividends will be passed. Moreover in reorganizations the preferred stockholder, regardless of protective provisions, is often

required to scale down his claims. If he forces dissolution, assets may be inadequate to repay him in full, whereas if he accepts some other form of security the company may work out of its difficulties.

The more closely preferred stocks resemble fixed income bonds, the more closely will their prices fluctuate with bond prices. If they are more like common stocks, their prices will follow the general trend of common stock values.

In order to determine the desirability of a preferred issue as an investment, therefore, it is necessary to follow the general economic conditions affecting both bonds and common stocks. It is also necessary to study all the privileges and restrictions attached to each particular issue.

There are undoubtedly many meritorious preferred stock issues, but as a general rule, the investor will find that either bonds or common stocks will fit his needs more satisfactorily and will prove more profitable in the end.

Common Stocks Provide for the Future

We have seen that since 1900, economic conditions were not favorable to bonds and the trend in industry began to bring common stocks to the attention of the investor. The era of consolidations had begun. United States Steel Corporation and many other of our industrial giants of today were formed by the consolidation of a number of small units just after the turn of the century.

The stock issues of these consolidations were necessarily much larger than those of the original companies. In order to attract the confidence of investors, corporations found it necessary to give more complete information regarding their operations and their financial conditions. Soon the stock exchanges throughout the country were carrying an increasingly wide list of stocks.

Interest in common stocks grew as bull markets lifted their prices to a peak. Interest waned as stock prices declined. The wide fluctuations in prices tended to obscure the growth element in

common stocks, and investors were slow to recognize that ownership in American business was paying larger and larger profits. Gradually, however, an increasing number of investors discovered that although bear markets caused a temporary halt in the progress of stocks, each successive bull market carried stock prices higher than the previous one. Many years of experience with fixed income securities has gradually forced them to realize that the assurance of dollar income in the future is not the most important investment objective. Investing today is based on the well founded theory that the real aim of most investors is not only to maintain but actually to raise their standards of living.

Society has not stood still during the last 25 years. The thousands of inventions which have completely revolutionized our economic and industrial life have also affected our social life, for each has resulted in one way or another in raising our standard of living. The income which provided a certain standard of living for our forefathers will not permit the same standard of living today. A fine span of horses or a single trip to Europe may have meant the

height of luxury in the 90's, but today the same relative social position only is attained by the "two car family," with yearly trips abroad, radios, and the thousands of other embellishments which social and industrial developments have made necessary.

A few years ago some startling conclusions were placed before the investing public by Edgar L. Smith and by Kenneth S. Van Strum. At that time Smith wrote "Common Stocks as Long Term Investments" and Van Strum wrote *"Investing in Purchasing Power." The purpose of both books was to prove by an actual statistical study of results over a long period of years that a diversified list of common stocks brought greater profits than bonds, both in terms of dollars and in purchasing power. These results were confirmed by comparing them with the actual results obtained by investors.

These studies pointed out the adverse effect of rising commodity prices for the bond holders. Furthermore, they showed that the common stockholder was benefited by rising prices. An advancing price level stimulates industrial production, and because the

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goods produced command a higher price, while the cost of producing them does not advance so rapidly, profits for the common stockholders show increases in each successive year. The stockholder receives larger dividends which more than compensate for the increased cost of living. Meanwhile, the bondholder's income remains the same in terms of dollars and actually decreases in terms of purchasing power.

Moderately declining commodity prices over a period of years do not injure the stockholder. When prices show a declining tendency the investor's money buys a larger quantity of goods. Furthermore the normal increase in population results in a steady increase in the profits of companies which manufacture products which are in public demand. Economic crises and the problems of overproduction may halt this rise temporarily, but eventually the growth factor will again be felt. Stock prices increase with the growth of the country; bond prices increase only with declining commodity prices or with falling money rates.

The growth factor of common stocks is most strikingly illustrated by the trend of dividend payments. One argument frequently used against common stocks is that their yield varies widely and cannot be depended upon. However true this may have been some years ago, the fact is that today dividends paid by corporations no longer fluctuate between periods of good and slack business.

Corporations are unwilling to pay dividends at a rate which they are not sure may be maintained. Consequently, dividend payments show a steady increase from one year to another. This trend, shown by the figures over the last 8 years time, is one of the strongest arguments in favor of common stocks as investments. A carefully selected, constantly supervised list of common stocks will show a steadily increasing return year after year, and will provide the owner with a purchasing power which increases as his needs increase. Today investors in common stocks need not fear a general reduction in dividends paid by corporations.

Wall Street Becomes the National Main Street

One impelling reason for buying common stocks of the large corporations should have unusual weight with investors in small cities and towns. In recent years the number of local common stock investment opportunities has been dwindling. Large corporations have invaded almost every Main Street in the Country. Chain stores of every form are supplanting local enterprises. Everywhere the small towns complain that "outside capital" is draining away the money that used to circulate locally. The independent merchant in most cases could have made larger profits by purchasing the stock of these competing corporations than he has made in operating his own business.

A new oil field is discovered; large corporations quickly gain control of it. Manufacturing enterprises pass from local to distant corporate ownership. Even banking is

developing into chains and groups and many local banks may soon be under "outside" control. In some respects we are becoming a nation of employees. On the other hand we hear of a "democracy of investors through widespread stock ownership."

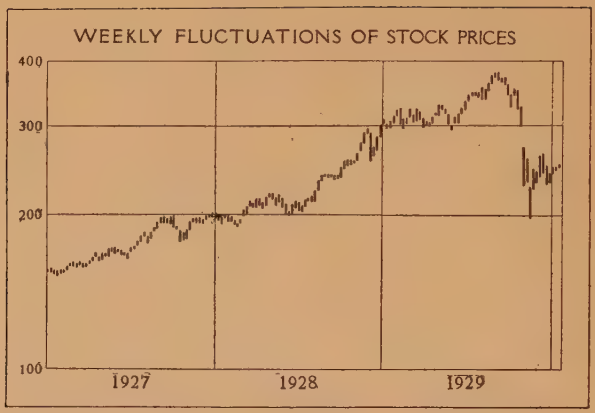
As corporations grow in size and absorb far-flung local units, there is only one way to maintain ownership in American business. That one way is to acquire stock-ownership in these large corporations which are taking away local ownership. Economic laws are inexorable. Only those who admit the inevitability of these laws will profit in their investments.

Short Term Trading

Undoubtedly one of the principal reasons many regard common stocks as too speculative for the average investor is that stock prices are changing constantly. They never stand still. Especially active and changeable are the prices of those stocks which have the brightest prospects, those which are strenuously discounting the uncertain future.

The inexperienced common stock investor may find that the stock which he purchased one day at 100 will rise the very next day to 101⅞ for no apparent reason. If a bond rose that much, many bondholders would feel justified in "taking their profit" and getting into some other bond issue.

The stock investor soon learns, however, that it is most unwise to take such small profits as a point or two. Such minor price fluctuations in stocks as occur daily and almost hourly are caused by the sensitivity of a highly organized market and no one except the



The entire market often surges forward for periods of ten days to three months before a significant change in trend occurs and a "technical reaction" sets in. These "short term" trends, which may be clearly seen from the weekly price fluctuations on the above chart, are caused by technical market conditions as well as fundamental economic factors. Those who wish to profit by these swings must act quickly.

professional trader on the floor of the Stock Exchange is in a position to take advantage of them.

As the common stock investor gains in experience he begins to notice more clearly defined trends in stock prices than the day to day fluctuations. Careful observation will show him that the entire market will surge forward for periods of from ten days to three months before a significant change in the trend occurs and a "technical reaction" sets in. In an upward move of this kind, prices of active stocks often rise as much as 15% in a short period of time. Stocks bought at 100 may rise to 115 within a few weeks, and then just as abruptly drop back to 105.

"Short term" trends, as those movements which last from ten days to a few weeks are sometimes called, include a great many more stocks than do the hourly and daily fluctuations. Because of their broader scope, they are more easily forecasted than the day to day movements, but because they are caused by technical market conditions as well as fundamental economic factors,

the investor must be prepared to act quickly if he is to take advantage of them. The amateur should not attempt short term trading unless he is provided with instantaneous advice from trained experts qualified to judge technical market conditions.

Catching the Big Swings

On all sides the investor will hear of bull and bear markets. The bull markets—prolonged periods of rising stock prices,—generally last from two to three and one-half years. Bear markets—prolonged periods of falling stock prices,—generally last from six months to a year and a half. Yet these movements do not repeat themselves with clocklike regularity, for the market is subject to fundamental economic forces which in themselves are constantly changing.

To obtain the most profitable results, it is of the utmost importance that the investor purchase stocks at the proper time in the cycle of stock prices. The importance of this fact was proved by Van Strum in his book "Forecasting Stock Market Trends." The fluctuations of every stock on the New York Stock Exchange during both bull and bear markets were analyzed over a period covering more than a quarter century.

Even in the mildest bull or bear markets the investor had only 17 chances out of 100 of selecting stocks which move against the trend. In any strong bull or bear market his chances were less than 10 out of 100.

When a bear market seems imminent, when stocks are selling too high in relation to present and prospective earnings, the common stockholder will be wise to convert those issues into cash and place his funds in some short term investment, so that when lower stock prices arrive he has his capital intact to take advantage of investment opportunities.

The investor who holds sound common stocks through a market break finds that they will reach even higher prices on the next major upswing. If, however, he wishes to increase his capital as rapidly as is consistent with safety, he should take advantage of every possible means of predicting these movements.

The Most Useful Barometers

"The big money must necessarily be in the big swing. Whatever might seem to give a big swing its initial impulse, the fact is that its continuance is not the result of manipulation by pools or artifice by financiers, but depends upon *basic conditions*. And no matter who opposes it, the swing must inevitably run as far and as fast and as long as the impelling forces determine.

"Hunches and mysterious ticker-sense haven't so very much to do with success. . . . Like the physician who keeps up with the advances in science, the wise trader never ceases to study general conditions."

These are the words of Jesse L. Livermore, one of the largest stock traders of all times. Thus does one of our most successful operators pay tribute to the necessity of following basic factors. No investor can afford to ignore them.

There are so many factors which influence the trend of stock prices that thousands of field agents,

statisticians and economists are required to gather and compile the statistics which reveal the true state of affairs. The investor is besieged with figures showing business failures, commodity prices, pig iron production, chain store sales, bank statements, money rates and car loadings. But facts of this sort are useless without the ability to translate them into definite terms of buying and selling.

Moreover, because stock prices usually anticipate economic developments, statistics are doubly confusing to the average investor. For instance, large earnings are usually well discounted in advance and by the time the earnings are actually reported the stock has already risen in price. Many investors avoid a stock whose earnings are low when actually that stock may be expected to move up sharply in anticipation of improved conditions.

Kenneth S. Van Strum has written an exhaustive work dealing with the various methods of predicting stock movements. In *"Forecasting Stock Market Trends,"

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many statistical records are analyzed. Each series of figures representing some particular phase of industry or economic development is correlated with the trend of stock prices. From such comparisons, extending back as far as records were available, he developed a method of forecasting the general trend of stock prices. The method of forecasting thus outlined has proved itself in forecasting accurately every major movement in stock prices in the past twenty-five years.

In his research work, Van Strum found it necessary to keep constant statistical records of all phases of the business situation. Of these, the following are among the most valuable in predicting stock prices.

Corporation Profits and Losses—Number business failures; railroad gross earnings; dividend payments, corporation earnings.

Commodity Prices—Prices pig iron, bar iron and coke; indexes of wholesale prices; composite price of iron and steel products.

Production and Consumption of Goods—Production of bituminous coal, pig iron, steel, and coke; indexes of production; sales by retail stores.

Volume of Trade—Car loadings of ore; of forest products; and of coal and coke.

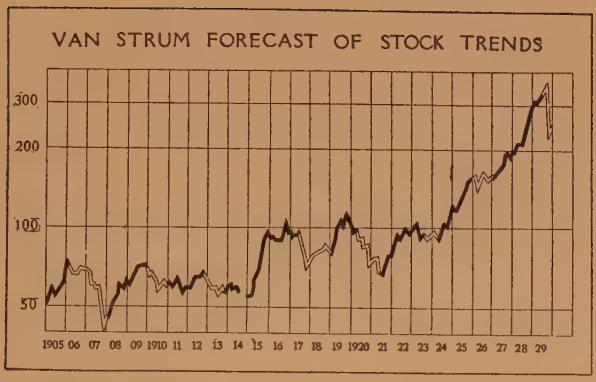
Money and Banking—Loan, deposit ratios of banks; Federal Reserve rediscounts; call money rates; commercial paper rates.

Investment and Speculative Activity—Dow-Jones averages; Fisher's and Barron's averages; Bond yields; volume of trading; technical position of stocks.

Each of the above factors has a definite relationship to the value of stocks, and is therefore definitely related to the trend of stock prices. The meaning of these statistics must be comprehended fully by the investor if he is to forecast the trend of stocks accurately.

The more significant statistical series, Van Strum combined into one index, thus obtaining the vital information given by each in a way which showed the future trend of stocks with remarkable accuracy. This forecasting curve is highly sensitive and it gives a composite picture of fundamental economic conditions. When its movements are considered in the light of the past and projected into the future, it permits an unusually accurate forecast of stock prices.

No method of forecasting can predict the absolute highs or lows of a market move, but this method approximates these points very closely.



Van Strum combines the significant statistical series, which show fundamental economic conditions, into one index which is used to forecast future stock prices. When the above chart of the Dow-Jones averages is shown as a black line, the Van Strum forecast was for generally rising prices. When the black line changes to a light open line, it is used as a signal to sell stocks. This index has been in actual use for a number of years. It forecasted accurately the rising market from January 1927 to July 1929. In this latter month it turned definitely bearish, thereby predicting the break in stock prices during the latter half of 1929.

No investor can afford to ignore fundamental economic conditions. By disregarding these forces he may find that a bear market will drive his stocks down to half their former value.

The Law of Growth

Even though technical and fundamental conditions point to an upward trend of stock prices, the investor has yet other decisions to make. Which stocks shall he buy? The necessity for careful selection is all too well known to require comment.

The first consideration is the possibilities offered by different industries. Investors should select those industries which are experiencing the healthiest and most rapid growth, and avoid others which are stationary or show a declining trend.

It is no simple matter to follow industrial trends in this scientific age. In the United States about 1840, canals and toll bridges were considered safe investments, while railroads were believed to be risky speculations. Somewhat later canals and toll bridges lost favor and the railroads gained in popularity. Horse cars enjoyed a period of investment popularity, but were replaced by electric trolley cars, which in turn are being

supplanted by bus lines. In another twenty years bus lines may be as obsolete as horse cars are now.

Investors must watch for developments which may render valueless stocks they are holding. At the same time, a new invention requires a long period of time to develop fully and win public approval, so it is equally important not to discard one's stock on the basis of a new invention only.

Some investors do not buy stock in an industry until it has already reached its full growth, when further progress is dependent upon such slow moving factors as the growth of population. These are the people who require that their stocks have a twenty year unbroken dividend record behind them.

Another type of investor gambles large sums on the speculative possibilities of a new industry before it can possibly pay large returns. He takes the chance that new inventions, new oil fields, or some other new development will make an immediate fortune for him.

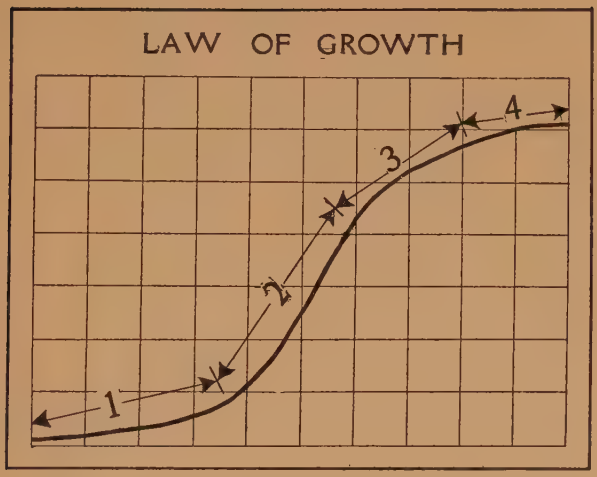
But the fullest rewards will be obtained by investors who concentrate in industries which are just entering a period of rapid development. This phase of an industry's growth has been termed by Raymond B. Prescott as "the period of growth into social fabric."

Prescott suggests that perhaps "all industries whose growth depends directly or indirectly upon the ability of the people to consume their products" pass through certain similar phases in the course of their development. These stages he terms:

1. Period of experimentation
2. Period of growth into social fabric
3. Period in which growth increases, but at a diminishing rate
4. Period of stability

The accompanying graph illustrates the normal development of such an industry.

During the early period of experimentation, the industry is little better than a gamble, for weaker organizations often do not withstand the trials of the experimental phase. Thousands of stockholders lose their money in this stage.



It has been pointed out by Raymond B. Prescott that every industry passes through four stages of growth, viz., period of experimentation, rapid growth, continued growth at a slower rate, and finally stability. During the first stage the risks of investing are very great. In the third and fourth stages opportunities for profit constantly grow smaller. The investor should select industries that are just entering the second phase, which is the period of most rapid and profitable growth.

During the second stage of growth the industry's earning power is increasing most rapidly. During this period the industry gains a definite place for itself as one of the country's leading industries. It is in this stage of growth that profit opportunities are greatest.

During the third and fourth periods, the future is so well assured that stocks of companies within the industry have discounted their prospects well into the future. The trend of prices will continue upward as long as the industry shows progress, but that progress must be expected to be slow and to correspond more to the growth in population. It will not match the growth of the newer and faster growing industries.

Naturally each industry varies from others in the length of time required to reach or complete one of these phases.

Every major industry, —railroad, motor, electrical, chemical, radio, aeroplane, and so on,— either has or may be expected to follow this course in its development. Often during the

third or fourth stage an industry gains new life from some new invention or development and earnings rapidly shoot upward again. Such was the case with the motion picture companies, when the invention of talking films injected new life into an industry which had about reached the limit of its development. As a rule, however, when an industry does show signs of slowing up, the aggressive investor will look elsewhere for his investments.

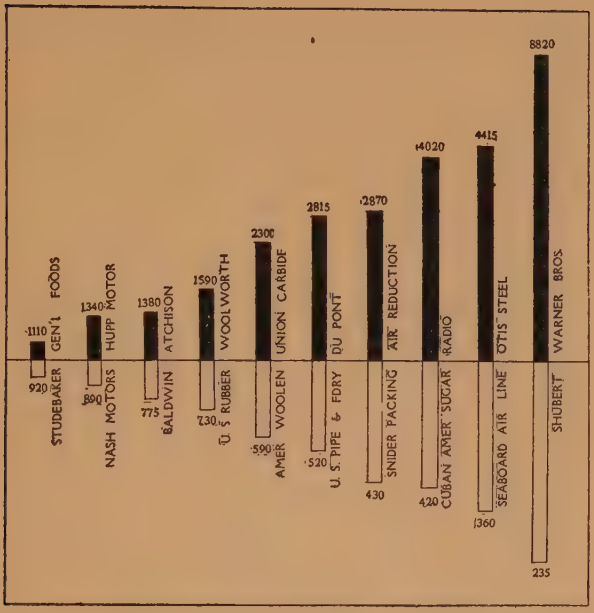
In order to increase his capital as rapidly as is consistent with safety, the investor should keep his funds employed in industries which are progressing most rapidly. He must therefore be constantly on the alert to shift to other fields when the old ones seem to have reached the period of diminishing rate of growth.

How to Select Profit-Making Stocks

After being assured that economic and technical market conditions point to a period of rising stock values, and after determining which are the industries due to develop most rapidly, the investor is then faced with the problem of choosing specific stocks. This entails an investigation of the various companies in an industry.

Several industries may have unusually bright prospects, yet the prospects of companies within those industries vary widely. Careful selection is absolutely necessary. Continuous profits will build fortunes quickly, but occasional losses cause severe setbacks.

The accompanying chart illustrates this point. It shows the results of investing $1,000 in each of 20 different stocks in 1927. The prices of half of these stocks advanced very substantially; those of the other half declined. The investor who bought U. S. Pipe and Foundry saw his $1,000 reduced to $500,



The chart shows the results of investing $1,000 in each of 20 stocks at their low prices of 1927. Prices are taken after the 1929 market break.

Careful selection will bring large profits. Indiscriminate buying results in losses which delay one's investment success for years.

whereas if he had bought DuPont, his capital would have increased to $2800. To attain the position of the DuPont investor he must make a profit of 460% on his remaining $500. In the meanwhile he has lost years of valuable time. For this reason, if for no other, the investor must carefully investigate the possibilities of each company before buying its stock.

Bondholders are trained by experience to judge the value of a bond by the actual physical property behind it. They seek to determine whether in default of interest payments, they can be assured of receiving their original capital intact. Some stockholders use this method of judging stock values. The physical assets of a company however do not show the investment value of its common stock. In the first place, there is no uniform method for determining "book value," for it depends largely on the accounting practices of the individual company.

One company values patents and goodwill at $10,000,000. Another with patents and goodwill of even greater value writes

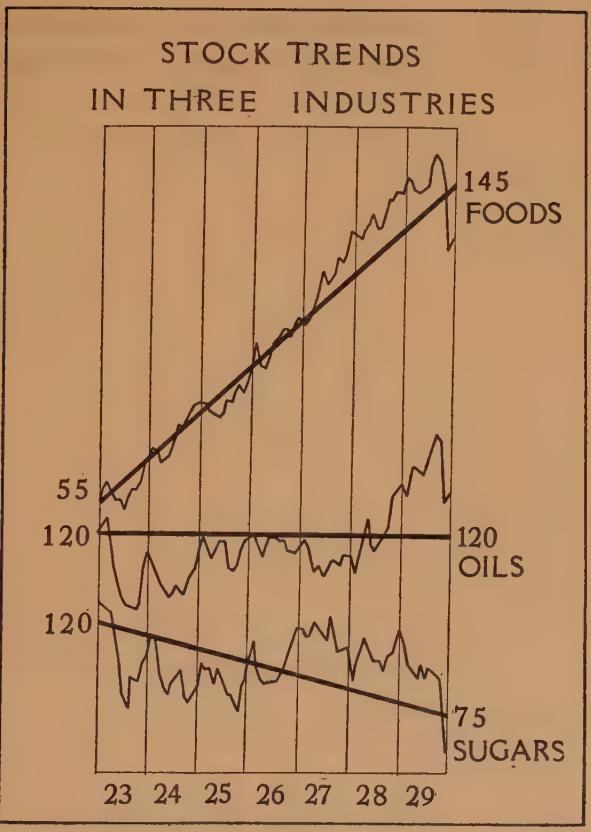
them down to $1. One company carries its plant at $1,000,000 while another with exactly the same type of plant makes such heavy depreciation charges that its book value is reduced to half that amount. The same is true in the case of investments. On one company's books they are placed at the prices paid, although these prices may be ridiculously low in comparison with the present market prices. Another will give the current market price. One carries inventories at cost prices even though they had been bought at materially higher prices; another carries inventories at current market levels.

Conservative accounting methods can be carried to an extreme. One New England mill owner is reported to have carried cash in banks at 10 cents on the dollar on his books. When called to task for thus concealing the company's assets he stated that after all the bank might fail! There are not many such cases, but it is true that stocks of approximately equal value may be carried by one company at $50 and by another at $100. It is therefore

obvious that the accounting methods of a concern play a large part in determining the real value of the stock.

But common stock investors should realize that the break-up value of a stock is not an essential consideration. They are not creditors of the business; they are owners, and as owners they are primarily interested in the company's ability to make a profit,—they are interested in it as a going concern. A business usually liquidates only when it is in such poor condition that it cannot possibly continue to function. By that time it has eaten so far into its revenues and its properties are so badly in need of repair that its assets never bring as much as the books would indicate they should. Stock prices are determined almost entirely by earning power.

The common stockholder invests primarily to make a profit. After he has determined that conditions within an industry are favorable, he wants to know which company in that industry is most favorably situated to bring him the greatest profits. Book values do not show this.



The trend of earnings is the most important factor in judging stock values. In the period covered by the chart, food companies showed steadily expanding earnings, whereas earnings of the oils were erratic, and earnings of sugar companies steadily declined. The investor who wishes to make consistent profits must study current industrial trends closely in order to keep his funds only in stocks of industries whose earnings are expanding most rapidly.

Many investors also believe that the yield on a stock shows its worth as an investment. They are of the opinion that a higher yield signifies that a stock is selling out of line with others, and that it should advance in price until it sells on the same yield basis.

Although in a few isolated cases this reasoning holds true, it is not wholly sound, for the value of a stock is determined not only by present yield but future yield. Since future yield depends on present and future earnings of the company, it is again obvious that earning power is the primary consideration.

The following table presents a simple explanation of why some stocks sell on a high yield basis while others sell on a low yield basis. The earnings of three stocks, A, B and C for the past five years are tabulated.

	A	B	C
1925	$8.51	$6.76	$4.22
1926	7.38	7.04	5.13
1927	6.91	6.86	6.27
1928	6.12	6.63	7.34
1929	5.76	6.94	8.01
Total Earnings	$34.68	$34.23	$30.97
Yield on Present Price	8.25%	6.01%	4.02%

Both A and B show a materially higher yield than C, but the C stock will interest the experienced investor more than the other two, for the trend of C's earnings is definitely upward, and the stockholder wants earnings in the future, not in the past.

He will therefore pay less for a stock like A whose earnings are declining steadily, or like B whose earnings show no sustained upward trend, and will pay a good price for a stock like C whose earnings show constant expansion. In buying C he has a good chance of increasing his income during the next three or four years. In buying A or B his income is likely to remain about the same and may even decline.

High yield alone, therefore, is not a simple index to a stock's value. The investor should not rely upon it any more than upon book value.

Another all-important factor in the analysis of any stock is Management. If the investor knows that the management is of the very best and that conditions within the industry are favorable to future growth, then most of his problems of analysis are solved.

A good management will see that generous reserves are set aside for future contingencies, that assets and goodwill are conservatively valued on the company's books, that it has plenty of working capital and that the plant is in good condition. Good management is the best possible assurance that the growth of the company will continue along sound, profit-making lines, that the business will enjoy public goodwill, and that satisfactory profits will be returned to stockholders.

The problem of determining which company has the best management is not so simple. One must study the company's history, its past record, its present activities and its plans for the future. If these are of the best, the favorable intangible factors may be expected to be present or materialize in the future.

Even with the assurance of good management in the past and at present, the investor must keep constantly in touch with the company's activities. When conditions within an industry become distinctly unfavorable, even the best-managed companies will make but slow progress.

Sound Investment Counsel

Realizing that the only way to make consistent profits in the security markets is to obtain expert, complete, accurate, and unbiased information about every phase of the economic situation, a few large investors, such as Arthur Cutten and the Fisher brothers, maintain organizations of experts. But comparatively few investors can afford to have their private staffs of economists, statisticians and investigators to interpret the movements of the industrial situation and the security markets.

The VAN STRUM FINANCIAL SERVICE was organized to provide investors with the information they require. Its sole business is to obtain and provide its clients with unbiased advice on investment matters.

It has no securities to sell, owns no interests in any securities, has no connection with any other company in any field of activity.

Its only profits are derived from the fees of its clients. Under these circumstances it is obvious that the success of the VAN STRUM FINANCIAL SERVICE in the past is a direct result of the goodwill which has been built up among its clients. The future success of this organization depends on its ability to continue to give profit-making advice.

The VAN STRUM FINANCIAL SERVICE is not a statistical organization, compiling financial and economic data for resale to investors. Instead, its main purpose is to analyze all available information and to translate it into definite advice for investors and traders.

The most useful data showing every phase of the investment situation has been collected over a long period of years, and is used as a background for analysis. The best authorities on every investment problem are constantly being consulted for their interpretation of the current situation. These experts include engineers, economists, commodity market specialists, sales engineers, sales production managers, and stock market authorities. Their reports cover all statistical information applicable to the industrial, railroad,

public utility and other fields. They cover everything from new mechanical and chemical processes to credit conditions, and this comprehensive material is translated by the Directors of the VAN STRUM FINANCIAL SERVICE into definite advices for the investor.

Through this service the investor is given the proper perspective on business in all its phases—its history, recent development and future outlook. As new processes appear and old ones are discarded, the businesses which these developments affect are followed closely and clients learn immediately if they should get into or out of the changing industry.

Every danger spot is carefully avoided. Every profit opportunity is uncovered. The VAN STRUM FINANCIAL SERVICE is alertly watching for any sign of a new trend which will prove to the advantage of its clients.

Continuous Unbiased Advice

The VAN STRUM FINANCIAL SERVICE collects and interprets all statistics and information which have any bearing on the economic situation, and the Directors of the Service have this information constantly under surveillance. They have developed methods of forecasting based upon fundamental economic factors, and make their recommendations only after the most exhaustive studies of a company, its management, and the industry in which it operates. Besides using all possible tangible facts in their estimates of the business situation, they take into consideration such other factors as the effect of public psychology on investing, the action of a stock on the tape, and the action of the general market. Their accuracy in forecasting is a matter of public record.

These experts are not merely theoretical economists, but practical men who have been making more than ordinary profits for their clients. Their unusual record throughout the market break of 1929 is perhaps the best

evidence of their ability to make money for their clients in any situation.

There are two phases of the VAN STRUM FINANCIAL SERVICE,—the Bulletin Service and the Supervisory Service.

The Bulletin Service is designed primarily to assist investors whose capital is less than $20,000. On enrolling for this Service, the new member submits his list of holdings, a statement of the amount of cash he has available for investment, and any personal information which will help the directors to formulate for him an intelligent investment program.

He then receives a complete analysis of his holdings in which he is told specifically which securities he should continue to hold, which he should sell, and which new ones he should buy. An investment program is outlined to fit his own personal requirements and objectives.

Inquiry and consultation privileges are extended as a part of the Service. Information or advice regarding investment problems is provided by mail, telephone or wire, as the member requests. The client is urged to submit his list at least

twice a year in order that he may be notified of any changes which may seem desirable.

The member receives weekly bulletins in which the results of the analytical work carried on by the organization are presented clearly and concisely. Every bulletin contains a limited number of definite recommendations designed to meet the needs of three classes of investors: those desiring appreciation in value during the next few months; those interested in rapid growth in value over a period of years; and those who wish to obtain a large current income from their securities. From week to week, the securities recommended are followed in the bulletins so that the investor is kept constantly in touch with his holdings. When it is advisable for one or another type of investor to sell one of these recommended stocks, he is told to do so in the bulletins.

In order that the investor may follow the advices more intelligently, the bulletins keep him fully informed on all phases of the business situation which have any bearing upon security values.

New industrial and financial developments are discussed and their probable effect upon stock prices is pointed out.

In short, the Bulletin Service gives the investor of moderate capital unbiased and continuous advice on all phases of his investment program. With its assistance he can formulate a sound investment policy which will show substantial profits over a period of years. The entire organization stands ready to help him solve any problem that may arise.

Personal Supervisory Service

The Van Strum organization originally maintained only a Personal Supervisory Service, which is more directly personal than the Bulletin Service and which is designed primarily for investors whose funds amount to more than $20,000.

As investment funds grow their management becomes more difficult. Furthermore, no individual except the professional investor has the facilities for adequately watching over a large investment fund. The Van Strum Personal Supervisory Service takes over the complete task of supervising an investment fund in its every detail, except the actual physical handling of the securities, which is of course left to the owner.

The subscriber to this Service provides information concerning his tangible wealth, the approximate value of any real estate he may own, the amount of insurance carried, the amount of

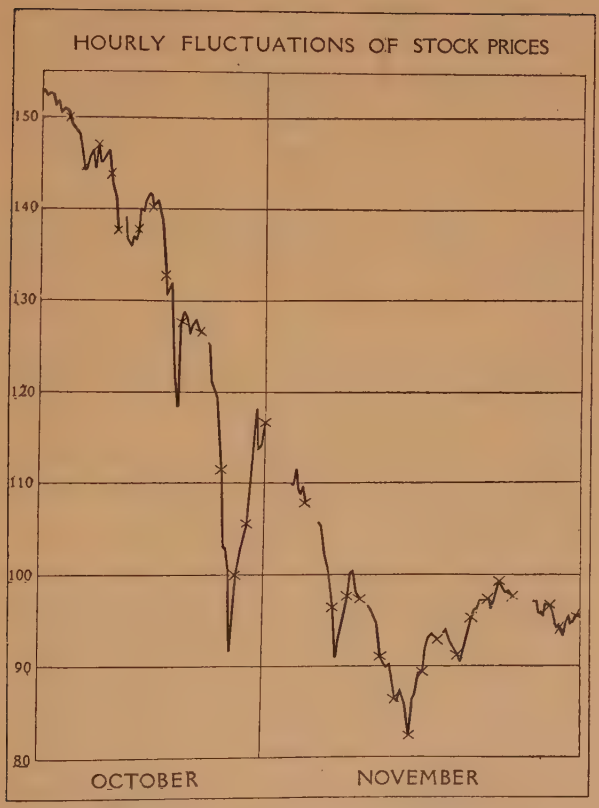
capital invested in savings bank deposits, bank acceptances, short term notes, commercial paper, building and loan shares, etc. He also supplies a list of his bonds and preferred and common stocks. He states his investment objective, whether he is investing primarily for short pull, long pull appreciation in value, or a safe, steady income. He states whether his securities are owned outright or on margin, and gives any other information regarding his various investments which may have any bearing upon the investment program which is to be laid out and supervised for him by Van Strum experts.

Each client's situation is discussed before a meeting of the Directors of the Service, and only after careful consideration of every aspect of the case in hand is an investment program planned. This plan is then put into effect by the one Director who will deal personally with the client. If the investment program thus laid out is not thoroughly satisfactory to the client, the Director acts as his representative in bringing his point of view to the other Directors, with whom he is always in touch.

Each Director represents only as many clients as he can give complete personal attention. The Service is particularly proud of the personal relationship that has always been maintained with its clients, and believes that this relationship must be continued if future results are to be as satisfactory as those obtained in the past.

The client's holdings are registered in various departments in the offices of the Service in such a way that whenever a change in the technical condition of the stock, the general trend of the market, or in conditions within an industry or a company makes it advisable to make a change in his list, that information will immediately be placed before his personal Director. The Director then advises the client as to the exact amount of each stock to be sold or purchased.

Thus, the VAN STRUM FINANCIAL SERVICE assumes the initiative in recommending any changes which may be advisable. This removes from the client the responsibility of deciding the time and the price at which stocks should be bought or sold.



Dips and rallies in stock prices occur constantly during each day's trading. The Van Strum Service keeps in constant touch with clients, and by the use of its wire service enables them to make purchases and sales at the most advantageous prices possible. The saving on one or two transactions will often more than pay the annual cost of the Personal Supervisory Service.

Unless a client requests otherwise, all advices are wired. Thus no time is lost. These messages are given the highest preferential rating by the telegraph companies, taking precedence over all other classes of messages. A direct wire telegraphic machine installed in the Van Strum offices connects with the main trunk lines which radiate to all sections of the country. It is not unusual for advice to be in the hands of the clients 15 minutes after a sudden change in stock market conditions has occurred. Also, by means of this device telegrams which are sent by clients are transmitted direct into the offices of the Van Strum Service. The speed of this wire Service is particularly valuable in giving clients immediate advices to buy or sell stocks, for prices are constantly fluctuating.

The chart on page 71 is similar to one kept up-to-the-minute in their offices, and shows the market fluctuations from day to day. It will be noted that during the week stocks often move lower or higher than their opening or closing prices.

The Van Strum market observers can often approximate the week's lows or highs and can pass on this information by wire to clients, thereby enabling them to obtain better prices in their trading. The market value of a client's holdings often fluctuates more in a day than the annual cost of the Personal Supervisory Service. One advantageous purchase made possible only by telegraphic service often more than pays the annual fee.

The VAN STRUM FINANCIAL SERVICE, with its research facilities and its men trained in every branch of the investment field, keeps constant watch over the investments of its clients. Its directors approximate with unusual accuracy the best time to buy, and the best time to sell securities.

Finally, when fundamental economic forces indicate clearly that a period of either rising or falling stock prices is to be expected, the directors of this Service immediately notify every client. The purpose of the Van Strum Supervisory Service is to select securities carefully, to supervise them constantly, and sell them at the opportune time, thus enabling clients to obtain a full measure of investment success.

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